

1991

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Recommended Citation

Constantine N. Katsoris, *Punitive Damages in Securities Arbitration: The Tower of Babel Revisited*, 18 Fordham Urb. L.J. 573 (1991).
Available at: <https://ir.lawnet.fordham.edu/ulj/vol18/iss4/1>

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PUNITIVE DAMAGES IN SECURITIES ARBITRATION: THE *TOWER OF BABEL* REVISITED

Constantine N. Katsoris*

I. Introduction

Can I or can't I? That is the question facing thousands of arbitrators sitting in securities arbitration disputes throughout the country considering requests for punitive damages. In other words, should an arbitrator punish the wrongdoer beyond the actual compensatory loss suffered by the complaining party? More importantly, does an arbitrator have the authority to award such damages?

The decision of whether to award punitive damages, however, is not limited to securities arbitration. Indeed, other industries, businesses and professions have also wrestled with the propriety and effects of punitive damage awards.¹ As a result, judges and scholars alike have been raising and debating fundamental questions in an at-

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1. See L. SCHLUETER & K. REDDEN, PUNITIVE DAMAGES (2d ed. 1989) § 1.0 [hereinafter SCHLUETER & REDDEN]. For example, regarding: defective products, see *id.* at § 9.5; medical malpractice, see *id.* at § 9.11(D)(2); attorney malpractice, see *id.* at § 9.11(D)(3); druggist malpractice, see *id.* at § 9.11(D)(4); accountant malpractice, see *id.* at § 9.11(D)(6). See also Freudenheim, *Business and Health Debate on Plan to Limit Lawsuits*, N.Y. Times, May 28, 1991 at D2, col. 1; Dunne, *Pass Bush's Civil Rights Measure*, N.Y. Times, June 1, 1991 at L23, col. 3; Review and Outlook, *American Competitiveness*, Wall St. J., Aug. 14, 1991 at A8, col. 1; *A Plague of Lawyers*, The Economist, Aug. 10, 1991 at 13; Hiltz, *Bush Enters Malpractice Debate with Plan to Limit Court Awards*, N.Y. Times, May 13, 1991, at A1, col. 1; Stout, *Bush Seeks to Compel States to Limit Damage Awards in Malpractice Cases*, Wall St. J., May 16, 1991 at A4, col. 1; Quayle Asks Curbs on Punitive Awards, N.Y.L.J., Aug. 14, 1991 at 3, col. 3; Consumer Group, *Bar Association Blasts Quayle's Legal Reform Plan*, Investor's Daily, Aug. 15, 1991 at 20, col. 1; Katsoris, *Accountants' Third Party Liability — How Far Do We Go?*, 36 FORDHAM L. REV. 191 (1967-68); Legal Affairs, *The Class Action Against Product Liability Laws*, Business Week, July 29, 1991 at 74; Editorial, *A Trojan Horse*, Nat. Law J., Aug. 5, 1991 at 12, col. 1.

EVERY YEAR SOMEONE in Congress tries to muster support for a federal products liability law. And every year, the proposal seems to fall by the way-

tempt to determine when and how punitive damages should be awarded. For example, what are the guidelines for imposing such damages? When are they justified? Even when justified, are they excessive, and do they therefore defeat the punitive or deterrent effect which they originally sought to accomplish? To date, no clear resolution is in sight. Indeed, it often appears as though the courts and legislatures were creating a "Tower of Babel"² by discussing the issue in differing languages and dialects.

It is not, however, the aim of this article to solve the punitive damages puzzle. Instead, after briefly outlining the nature of punitive damages and tracing the background of securities arbitration, the discussion will settle on the narrower topic of whether punitive damages — in whatever form permitted in courtroom litigation — should be allowed to be meted out by non-judicial arbitrators sitting in consensual forums involving securities disputes.

II. Punitive Damages

"Punitive" or "exemplary" damages — in excess of compensatory damages³ — are widely recognized in civil litigation. Indeed, multiple or punitive damage awards have been in existence since the Code of Hammurabi in 2000 B.C.⁴ Such damages are generally accepted or rejected on policy grounds, and are usually imposed to punish the defendant and serve as a warning or example to others who may com-

side. This year's legislative session has brought us the Product Liability Fairness Act of 1991.

There are seductive justifications for a comprehensive, nationwide law. The United States has become a national market. The patchwork quilt of state laws presents a bewildering challenge to manufacturers and their lawyers. A federal regulatory scheme would bring some coherence to the law.

But in the past, similar proposals have been a barely concealed effort to restrict the rights of consumers to bring suit against manufacturers that sell defective and dangerous goods. This year's version mostly avoids harsh limits.

Still, plaintiffs' lawyers and their allies are saying the new modest proposals lay the path for more restrictive measures. If that's the case, it does a disservice to the public, which is owed a full and comprehensive debate of the issue."

Id.

2. Babel is a biblical city where the building of a tower is held in Genesis to have been interrupted by the confusion of languages. *See Genesis* 11:1-9. *See also* WEBSTER'S NINTH NEW COLLEGIATE DICTIONARY 122 (1989).

3. Those allowed as a recompense for the injury *actually received*. *See* 1 BOUVIER'S LAW DICTIONARY 750 (3d rev. 1914) (emphasis added).

4. *See, e.g., THE BABYLONIAN LAWS* 19, (G. Driver & J. Miles trans. 1955). "If the seller (meanwhile) goes to (his) fate, the buyer shall take 5-fold (the amount of) the claim in that suit from the house of the seller." *Id.* *See also* SCHLUETER & REDDEN, *supra* note 1, § 1.0 at 3.

mit similar outrageous acts in the future.⁵ In justifying this rationale of deterrence, most courts require a finding of malice or some other comparable act.⁶

Although exemplary damages are punitive in nature, they lack the safeguards generally afforded criminal penalties.⁷ Furthermore, because of the frequency and magnitude of punitive damages,⁸ the validity and propriety of such awards has come under increasing scrutiny by the courts, legislatures and legal scholars.⁹ In fact, the turmoil and uncertainty surrounding the excessiveness of punitive damage awards was recently raised before the Supreme Court in *Pacific Mutual Life Insurance Company v. Haslip*.¹⁰ In upholding the punitive damage award at issue, the Court left undecided the extent to which "due process" acts as a check on a jury's discretion to award punitive damages in the absence of any express statutory limit.¹¹ In a dissenting opinion, however, Justice O'Connor pointed out that:

[U]nlimited jury discretion — or unlimited judicial discretion for that matter — in the fixing of punitive damages may invite extreme results that jar one's constitutional sensibilities. . . . We need not, and indeed we cannot draw a mathematical straight line between the constitutionally acceptable and the constitutionally unacceptable that would fit every case. We can say, however, that *general concerns of reasonableness and adequate guidance from the court when the case is tried to a jury properly enters the constitutional calculus*.¹²

5. See SCHLUETER & REDDEN, *supra* note 1, § 2.1(c) at 23.

6. *Id.*, § 2.2(a)(1) at 26. The rationale of deterrence is particularly justified where the wrongdoer has received or expects to receive financial or other benefits from his misconduct. *Id.* Moreover, punitive damages act as an incentive to wronged parties to seek redress, even though their damages — in relation to the relative cost of litigation — are nominal; otherwise, the wrongdoers' behavior would go unchecked to the detriment of society as a whole. *Id.*, § 2.2(c)(1) at 30-31.

7. See SCHLUETER & REDDEN, *supra* note 1, § 1.3(F) at 11.

8. See Jeffries, *A Comment on the Constitutionality of Punitive Damages*, 72 VA. L. REV. 139 (1986); Note, *The Imposition of Punishment by Civil Courts: A Reappraisal of Punitive Damages*, 41 N.Y.U. L. REV. 1158 (1966); Note, *Punitive Damages: An Appeal for Deterrence*, 61 NEB. L. REV. 651 (1982).

9. See SCHLUETER & REDDEN, *supra* note 1, § 3.0 at 37.

10. 111 S. Ct. 1032 (1991).

11. Although the jury award was not broken down, it appears that over 80% of the more than one million dollar verdict was punitive in nature. *Id.* at 1037, n.2. See also *Pacific Mutual Life v. Haslip: Supreme Court Refuses to Specify Due Process Standards for Awarding Punitive Damages*, 4 SEC. ARB. COMMENTATOR 1, at 5 (Jan. 1991); Note, *Can Punitive Damages Withstand a Due Process Challenge After Bankers Life & Casualty Co. v. Crenshaw and Browning-Ferris Industries of Vermont v. Kelco Disposal?*, 18 FORDHAM URB. L.J. 121 (1990).

12. *Pacific Mutual Life*, 111 S. Ct. at 1043 (emphasis added).

One of the arguments against awarding punitive damages is that the law has already made sufficient provisions for deterrence and punishment that eliminates the need for exemplary damages.¹³ It is precisely for this reason that the securities industry feels punitive damage awards are inappropriate and unnecessary in brokers' disputes. To be sure, the heavy regulation of the securities industry on both the federal and state levels, supplanted by the industry's own self-regulating system,¹⁴ constitutes a significant deterrent by allowing for punishment of those activities which contravene industry rules and regulations.¹⁵ Accordingly, the securities industry takes the position that the enforcement procedures resulting from such regulation "serve the needs of society to hold out as examples those who violate the mores of the industry. This is done in a very public forum with all of the due process safeguards and is a far better manner than any private arbitration or, for that matter, private civil suit, could ever accomplish."¹⁶ *Needless to say, investors and their representatives do not share this conclusion.*¹⁷

The effectiveness of the securities industry's current mechanisms for deterrence, however, need not be addressed in this article. Rather, this article focuses on the assault against the awardability of punitive damages *through arbitration*, and rejects any notion that judges and juries can award punitive damages in securities disputes while arbitrators cannot.¹⁸ To whatever extent these damages are awardable in

13. For example, injunctive relief is available in equity to deter continued wrongdoing. See SCHLUETER & REDDEN, *supra* note 1, § 2.2(a)(2) at 28.

14. Organizations such as the National Association of Securities Dealers (NASD), The New York Stock Exchange (NYSE) and various other Securities Regulatory Organizations (SROs) act as internal regulators of the securities industry. See *infra* note 220 and accompanying text.

15. See Address by William J. Fitzpatrick (General Counsel of the Securities Industry Association) before the New York County Lawyers Association (May 29, 1991.) (A copy of this speech, entitled "Punitive Damages In Arbitration: Should They Be Permitted In New York State?", is on file at the office of the Fordham Urban Law Journal).

16. *Id.* at 7-8.

17. See S. GOLDBERG, PIABA'S 1991 REPORT ON PUNITIVE DAMAGES IN SECURITIES ARBITRATION 2 (1991): "In the final analysis, securities arbitration without the possibility of punitive damages being awarded in egregious cases, would be no more effective in discouraging grossly fraudulent conduct than would be a grand larceny auto theft statute that limited punishment upon conviction to divestiture of the stolen car." See also *Raytheon Co. v. Automated Business Systems, Inc.*, 882 F.2d 6 (1st Cir. 1989): "[P]unitive damages serve as an effective deterrent to malicious or fraudulent conduct. Where such conduct could give rise to punitive damages if proved in court, there is no compelling reason to prohibit a party which proves the same conduct to a panel of arbitrators from recovering the same damages." *Id.* at 12; Watterson, *Vulnerability Fate of Widows and Widowers*, Boston Globe, Sept. 9, 1991, at 20, col. 3.

18. See *infra* notes 72-146 and accompanying text. See also Stipanowich, *Punitive*

courtroom litigation, they should be similarly permitted in arbitration.

III. History of Securities Arbitration

Arbitration is hardly a modern day phenomenon. It was Aristotle who wrote:

Equity is justice in that it goes beyond the written law. And it is equitable to prefer arbitration to the law court, for the arbitrator keeps equity in view, whereas the judge looks only to the law, and the reason why arbitrators were appointed was that equity might prevail.¹⁹

The use of arbitration to resolve securities disputes is equally established; its origins trace back to the New York Stock Exchange (NYSE) in 1872.²⁰ Since that time, numerous other Securities Regulatory Organizations (SROs) have established arbitration programs for the settlement of such disputes.²¹

To fully understand the present rules governing the arbitration of securities disputes, it is important to look at the developments that have been responsible for channeling such disputes into arbitration.²² Consideration must also be given to legislative attempts to alter or influence the scope of securities arbitration.²³ Finally, the establishment and work of the Securities Industry Conference on Arbitration (SICA) and the oversight role of the Securities and Exchange Commission (SEC or Commission)²⁴ should also be examined.

Damages in Arbitration: Garrity v. Lyle Stuart, Inc. Reconsidered, 66 B.U.L. REV. 953 (1986).

19. THE ARBITRATOR'S MANUAL (compiled by SICA) (1989) (on file at the office of the Fordham Urban Law Journal).

20. P. HOBLIN, SECURITIES ARBITRATION PROCEDURES, STRATEGIES, CASES 1-2 (1988).

21. *Id.*

22. See *infra* notes 25-38 and accompanying text.

23. See *Draft Bill To Restrict Use of Pre-Dispute Agreements*, 1 SEC. ARB. COMMENTATOR 3, at 4 (June 1988); *State Actions on Pre-Dispute Clauses*, 1 SEC. ARB. COMMENTATOR 9 (Aug. 1988). Massachusetts, for example, undertook a particularly serious attempt to regulate arbitration agreements. See Neeseman, *After McMahon and Rodriguez: The State of the Law*, SEC. ARB. 217, 279.3 (1989). The Massachusetts rule barred licensed broker-dealers from requiring investors to sign pre-dispute arbitration agreements, and mandated that brokers disclose fully to investors the legal effects of arbitration agreements. In *Securities Indus. Ass'n v. Connolly*, both the District and Circuit courts ruled that such state regulations were preempted by the Federal Arbitration Act. 703 F.Supp. 146, 153 (D. Mass. 1988), *aff'd*, 883 F.2d 1114, 1120 (1st Cir. 1989), *cert. denied*, 110 S. Ct. 2559 (1990). See also Hinden, *GAO Asked to Investigate Securities Arbitration Issues*, Wash. Post, Feb. 7, 1990 at 2, col. 1.

24. See *infra* notes 39-57 and accompanying text.

A. SRO Arbitrations

An unresolved dispute between an investor and his broker ordinarily ends in arbitration because of an arbitration agreement executed at the time a customer opens an account with his broker.²⁵ Under the Federal Arbitration Act (FAA or Arbitration Act),²⁶ agreements to arbitrate future disputes are, for the most part, specifically enforceable.²⁷ Before 1987, however, it was generally presumed that claims based upon federal securities laws — namely the Securities Act of 1933²⁸ (1933 Act or Securities Act) and the Securities Exchange Act of 1934²⁹ (1934 Act or Exchange Act) — could not be arbitrated without the customer's consent, *despite the existence of a pre-dispute*

25. See Katsoris, *The Level Playing Field*, 17 FORDHAM URB. L. J. 419, 469 (1988-89) [hereinafter Katsoris I]. SROs require by rule that their membership consent to arbitrate disputes with their customers. By belonging to an SRO, members agree to be bound by the SRO's rules. Consequently, customers of an SRO may compel a member of an SRO to arbitrate; however, absent a written contract, the member cannot compel the customer to arbitrate. See P. HOBLIN, *supra* note 20, at 2-3 to 2-4. The standard arbitration clause "authorizes the customer to elect the arbitration forum from a list of several organizations. If the customer does not elect the forum within five days after receipt from the broker-dealer of a notification requesting such election, the broker-dealer becomes authorized to make the election." Exchange Act Release No. 15,984 n.4 (July 2, 1979), reprinted in 17 SEC Docket 1167, 1169 n.4 (June-Aug. 1979). The extent to which customers are, as a practical matter, "required" to sign what can basically be described as a typical industry-wide agreement containing a pre-dispute arbitration clause is a critical question. This is particularly so if "the customer may be precluded from doing business with the broker-dealer if he or she refuses to sign the agreement or the broker-dealer is unwilling to accept any modification of its terms." *Id.* at 1169. It would appear that such arbitration agreements are in effect largely with respect to margin, option and commodity accounts, and, to a lesser degree, cash accounts. See Stansbury & Klein, *The Arbitration of Investor-Broker Disputes: A Summary of Development*, 35 ARB. J. 30, 32 (1980); see also Fletcher, *Dynamism in Securities Arbitration*, in SECURITIES ARBITRATION PRACTICE AND PROCEDURES 1, 14 (1989). A "1988 SEC study of 65 brokerage firms showed that 61% of all cash accounts had no arbitration agreement in effect; 6% of margin accounts had no arbitration agreement; and 5% of option accounts had no arbitration agreement." *Id.* This difference probably stems from the fact that the latter two usually involve greater risk or an extension of some form of credit by the firm to the customer, thus increasing the need for speedy resolution of problems through arbitration. See also Ryder, *Securities Arbitration in 1989: Reviewing The Case Law, Securities Arbitration Practice and Procedures*, SEC ARB. INST. AND SEC. ARB. COMMENTATOR 37 (1989); Grant, *Securities Arbitration: Is Required Arbitration Fair To Investors?*, 24 NEW ENG. L. REV. 389 (1990).

26. 9 U.S.C. §§ 1-14 (1982).

27. Section 2 of the Arbitration Act provides: "A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." *Id.* at § 2. (emphasis added).

28. 15 U.S.C. § 77 (1982).

29. *Id.* at § 78.

agreement to arbitrate.³⁰

In 1987, the Supreme Court nullified this presumption in *Shearson/American Express, Inc. v. McMahon*³¹ by upholding the enforceability of pre-dispute arbitration agreements as to 1934 Act claims;³² shortly thereafter, in *Rodriguez de Quijas v. Shearson/American Express*,³³ the Court extended such enforceability to claims under the 1933 Act.³⁴ The significance of *McMahon* is evident in that it resulted in a dramatic shift in forum — from the courtroom to arbitration — for the resolution of securities disputes, particularly for 1934 Act claims.³⁵ In fact, in the first full year *before McMahon* (1986), less than 3,000 securities arbitrations were filed with participating SROs,³⁶ whereas in the first full year *after McMahon* (1988), over 6,000 securities cases were filed with participating SROs,³⁷ and nearly 500 with the American Arbitration Association (AAA).³⁸

B. Creation of SICA

Prior to 1977, most SROs had differing rules for the administration of securities arbitration disputes.³⁹ In June of 1976, the SEC began to address this problem by soliciting comments on the feasibility of developing a uniform system of dispute grievance procedures for the adjudication of small claims.⁴⁰ In response, several SROs proposed that a securities industry task force be established to consider the develop-

30. See *Wilko v. Swan*, 346 U.S. 427 (1953), which held that Congress' desire to protect investors would be more effectively served by holding unenforceable any pre-dispute arbitration agreements relating to issues arising under the 1933 Act. Most federal courts applied this prohibition equally to 1934 Act claims. See also Katsoris I, *supra* note 25, at 425.

31. 482 U.S. 220 (1987).

32. See Katsoris, *Securities Arbitration After McMahon*, 16 FORDHAM URB. L.J. 361, 366 (1987-88) (hereinafter Katsoris II); Karmel, *Arbitration and the Demise of Wilko v. Swan*, N.Y.L.J., June 15, 1989 at 3, col. 1.

33. 490 U.S. 477 (1989).

34. *Id.* at 483-85. See also, Katsoris I, *supra* note 25, at 426.

35. More Federal securities claims brought against brokers by the public are brought pursuant to the 1934 Act rather than under the 1933 Act. This is because the latter statute is concerned with the initial distribution of securities, whereas the former deals primarily with post-distribution trading. See Katsoris, *The Securities Arbitrator's Nightmare*, 14 FORD. URB. L.J. 3, 7 (1986) (hereinafter Katsoris III).

36. See SEVENTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION (July 1991) [hereinafter SEVENTH REPORT] (on file at the office of the Fordham Urban Law Journal.)

37. *Id.* For a breakdown of the arbitrations handled by the arbitration facilities of the various SROs since 1980, see *id.* at 24-27.

38. See Katsoris, *supra* note 25 at 469-70. To the extent the AAA acts as an alternative to SRO arbitration see *id.* at 469-72.

39. *Id.* at 427.

40. *Id.*

ment of such a uniform code.⁴¹ Accordingly, SICA — consisting of representatives of various SROs,⁴² the Securities Industry Association (SIA)⁴³ and the public⁴⁴ — was established in April of 1977.⁴⁵

Pursuant to its mandate, SICA first developed a simplified arbitration procedure for resolving small claims⁴⁶ and issued an informational booklet describing such procedures (Small Claims Booklet).⁴⁷ Realizing that the development of a small claims procedure was only a first step, SICA then developed a comprehensive Uniform Code of Arbitration (Uniform Code or Code) to be used by the securities industry.⁴⁸ In addition, SICA prepared an explanatory booklet (Proce-

41. *Id.*

42. The following SROs were represented: The American (ASE), Boston (BSE), Cincinnati (CSE), Midwest (MSE), New York (NYSE), Pacific (PSE) and Philadelphia (PHSE) Stock Exchanges; the Chicago Board of Options Exchange (CBOE), the Municipal Securities Rulemaking Board (MSRB) and the National Association of Securities Dealers, Inc. (NASD). FIFTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION 3 (Apr. 1986) [hereinafter FIFTH REPORT] (on file at the office of the Fordham Urban Law Journal).

43. *Id.* The SIA is a trade association for the securities industry.

44. Peter R. Cella, Jr., Esq., and the author have served continuously as Public Members of SICA since its creation in 1977; Mortimer Goodman, Esq. was similarly appointed as a Public Member in 1977 and continued to serve until he retired in 1989. *Id.* In 1983, Justin Klein, Esq., was added as the fourth Public Member of SICA. *Id.* Upon the retirement of Mortimer Goodman in 1989, James E. Beckley, Esq. was selected by the remaining public members to fill this vacancy. The current public members' terms shall expire one a year, beginning on December 31, 1989. See *SICA: Pre-dispute Clauses Stay in Customer Agreements*, 1 SEC. ARB. 6 (Sept. 1988). They are each eligible for reappointment for a new four-year term. All new members will serve for four years and are eligible for one additional four-year term. The public members whose terms are not expiring will determine the appointment of new members or reappointments. *Id.* The appointment, or reappointment, may be vetoed by a two-thirds vote of the non-public members of SICA. *Id.* Justin Klein, Esq., whose term expired at the end of 1990, was reappointed in 1991 to a new four-year term.

45. See FIFTH REPORT, *supra* note 42, at 3.

46. *Id.* The original jurisdictional limit for small claims was \$3,000 which was subsequently raised to \$5,000, and then again to \$10,000, the present limit. See *SEC Approves NASD Proposal to Raise Ceiling for Simplified Arbitrations*, SEC. REG. & L. REP. (BNA) No. 20, 15 560 (Apr. 15, 1988). See also *D. Lipton Study*, 1 SEC. ARB. COMMENTATOR 5 (June 1988); T. Wynn, *Seminar Highlights: Securities Arbitration Update*, SEC. ARB. COMMENTARY (Oct. 1989).

47. See REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION TO THE SECURITIES AND EXCHANGE COMMISSION: Proposals to Establish a Uniform System for the Resolution of Customer Disputes Involving Small Claims, "How to Proceed with the Arbitration of a Small Claim" (Appendix D) (Nov. 15, 1977) [hereinafter FIRST REPORT] (on file at the office of the Fordham Urban Law Journal). The small claims procedure was incorporated into § 2 of the Uniform Code of Arbitration. See THIRD REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION TO THE SECURITIES AND EXCHANGE COMMISSION 3 (Jan. 31, 1980) [hereinafter THIRD REPORT] (on file at the office of the Fordham Urban Law Journal).

48. See Uniform Code of Arbitration (as amended), reprinted in FOURTH REPORT OF

dures Booklet),⁴⁹ outlining procedures under the Code.

The original Uniform Code was adopted by the participating SROs during 1979 and 1980.⁵⁰ Since the adoption of the Code, SICA has regularly monitored its operation and made numerous amendments, revisions and additions thereto.⁵¹ In addition, SICA prepared an Arbitrator's Manual (Manual)⁵² to instruct arbitrators concerning their duties and responsibilities. This manual, along with the Code and the Procedures Booklet, continues to be revised and updated by SICA.⁵³

It should be noted that SICA has always been concerned with improving the image of SRO arbitration as a speedy, economic and fair method for the resolution of securities disputes.⁵⁴ SICA has also sought, to the extent possible, to achieve uniformity in the SRO rules and consistency in their application.⁵⁵ Moreover, since many of the post-*McMahon* changes have increased the duration and cost of arbitration proceedings generally,⁵⁶ resultant escalating costs have also become a concern of SICA. For these reasons, SICA commissioned a study in 1990 to examine the feasibility of using a single forum to administer all arbitrations involving the securities industry.⁵⁷ A report from this study has recently been submitted to SICA. Although SICA has concluded that no material economies of scale would result from a single forum, it will continue to explore methods of improving the governance and image of SRO arbitration.

THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION, Exhibit C (Nov. 1984) [hereinafter *FOURTH REPORT*] (on file at the office of the Fordham Urban Law Journal).

49. See *THIRD REPORT*, *supra* note 47, at 5. After *McMahon*, SICA consolidated the Small Claims Booklet, (*supra* note 47) into the *PROCEDURES BOOKLET*. See *SIXTH REPORT OF THE SECURITIES INDUSTRY CONFERENCE ON ARBITRATION 3* (Aug. 1989) [hereinafter *SIXTH REPORT*] (on file at the office of the Fordham Urban Law Journal).

50. See *FIFTH REPORT*, *supra* note 42, at 4. Every time SICA adopts a new rule, each SRO must generally seek a rule change from its respective organization and subsequently submit the proposed rule to the SEC for approval. Accordingly, there is often a time lag between SICA approval and SRO action.

51. See *SIXTH REPORT*, *supra* note 49, at 1-3.

52. *THE ARBITRATOR'S MANUAL*, *supra* note 19.

53. See *SIXTH REPORT*, *supra* note 49, at 3. After *McMahon*, the Small Claims Booklet was merged into the *PROCEDURES BOOKLET*. See *supra* notes 47 & 49.

54. See *Katsoris I*, *supra* note 25, at 430-31.

55. *Id.* at 452-54.

56. *Id.* at 472-75.

57. See Siconolfi, *Street Eager for Arbitration Superforum*, Wall St. J., Aug. 24, 1990, at C1, col. 1. See also Morris and Masucci, *Securities Arbitration at Self-Regulatory Organizations: New York Stock Exchange and National Association of Securities Dealers — Administration and Procedures*, in *SECURITIES ARBITRATION 1991*, at 219, 229 (PLI Seminar): "Increased caseload has strained the existing facilities. SROs are studying the feasibility of a central arbitration forum." *Id.*

IV. Punitive Damages in Arbitration

A. Relevant Federal Statutes

There are a variety of federal statutes dealing with substantive causes of action, choice of forum and form of damages, which impact securities arbitration and punitive damages. Collectively, these statutes send somewhat mixed signals regarding the awardability of punitive damages in arbitration. For example, the FAA, although silent on the specific issue of punitive damages, evinces a strong policy in favor of settling disputes through the forum of arbitration.⁵⁸ Furthermore, because the FAA applies to claims arising from transactions involving interstate commerce,⁵⁹ and because securities dealings usually involve such transactions, state securities claims, as well as those arising under federal securities laws, are usually subject to the FAA.⁶⁰

From a substantive perspective, however, claimants who choose to bring a cause of action under the federal securities laws may elect arbitration as a forum but are nonetheless precluded from recovering punitive damages.⁶¹ By the same token, other federal statutes mandate the type of damages to be awarded. Two noteworthy examples of such statutes — which proscribe damage awards known as “treble damages” at three times actual loss⁶² — are the Clayton Anti-Trust Act⁶³ and the Racketeer Influenced and Corrupt Organization Act (RICO).⁶⁴ Although some courts describe treble damage awards as *punitive*,⁶⁵ and others refer to them as *remedial*,⁶⁶ treble damages are decidedly punitive *in nature*.⁶⁷ Thus, it is noteworthy that the Supreme Court in *McMahon* unanimously⁶⁸ held that contractual agreements to arbitrate claims asserted under RICO are specifically

58. See *Moses H. Cone Memorial Hospital v. Mercury Constr. Corp.*, 460 U.S. 1 (1983).

59. See *supra* note 27.

60. See *Katsoris I*, *supra* note 25, at 424.

61. These claimants are equally precluded from recovering such damages in courtroom litigation. See SCHLUETER & REDDEN, *supra* note 1, § 19.2(F) at 330; William J. Fitzpatrick, *supra* note 15, at 8; S. GOLDBERG *supra* note 17, at 81.

62. See SCHLUETER & REDDEN, *supra* note 1, § 2.1(B) at 21.

63. 15 U.S.C. § 14 (1982).

64. 18 U.S.C. § 1964(c); See D. ABRAMS, *THE LAW OF CIVIL RICO* § 3.4.1 at 152 (1991).

65. In fact, the most common terms used to describe awards in excess of compensatory damages are “punitive” and “exemplary” and, in most jurisdictions, these terms are used interchangeably. See SCHLUETER & REDDEN, *supra* note 1, § 2.0 at 19.

66. *Id.*

67. *Id.*, § 2.1(B) at 21.

68. Although the court found unanimously on the RICO issue, it split 5-4 on the issue of the arbitrability of 1934 Act claims. See *supra* notes 31-38 and accompanying text.

enforceable,⁶⁹ suggesting that a punitive-like damage award is available through arbitration, at least for RICO claims. In fact, an arbitration award was recently vacated on the ground that an arbitration panel showed a manifest disregard⁷⁰ of the law in denying plaintiff's RICO Act claims.⁷¹

B. Forum Rules

Although the SICA Code does not specifically mention punitive damages, these damages are referenced in the Arbitrator's Manual⁷² which provides:

The issue of punitive damages may arise with great frequency in arbitrations. Parties to arbitration are informed that arbitrators can consider punitive damages as a remedy. Generally, in court proceedings, punitive damages consist of compensation in excess of actual damages and are awarded as a form of punishment against the wrongdoer. . . . If punitive damages are awarded, the decision of the arbitrators should clearly specify what portion of the award is intended as punitive damages, and the arbitrators should consider referring to the authority on which they relied.⁷³

Moreover, in order to prevent the insertion of restrictive clauses in customers' agreements, Section 31 of the Code specifically prohibits conditions that "limit or contradict the rules of the SROs, or limit the ability of a party to file any claim in arbitration or *limit the ability of the arbitrators to make any award.*"⁷⁴ Although this prohibition does not specifically mention punitive damages, it clearly expresses a strong distaste for restrictions in customers' agreements which limit the claim or award rendered by the arbitrators.⁷⁵ In this regard, choice-of-law provisions, which often appear in pre-dispute arbitration agreements and mandate the law to be applied in deciding the dispute, can be restrictive. This is particularly true where a choice-of-law provision subjects an investor to the law of a situs which has no true relationship to the place where the business was conducted.⁷⁶

It should also be noted that Section 28 of the SICA Code requires an award to include summary data, such as a description of the issues

69. *McMahon*, 482 U.S. at 242. See Katsoris II, *supra* note 32, at 368.

70. See *infra* notes 200-04 and accompanying text.

71. See *Robbins v. Paine Webber, Inc.*, 761 F. Supp. 773, (D. N. Ala. 1991)

72. See THE ARBITRATOR'S MANUAL, *supra* note 19 and accompanying text.

73. *Id.* at 20.

74. See SIXTH REPORT, *supra* note 49, at 12 (emphasis added). See also Katsoris I, *supra* note 25, at 452.

75. See Katsoris I, *supra* note 25, at 446.

76. See *infra* notes 109-45 and accompanying text.

in controversy and the amounts claimed and awarded.⁷⁷ Although neither the NASD nor NYSE rules directly authorize punitive damages, the printed award form used by the NYSE designates a space for the insertion of "punitive damage" awards.⁷⁸ More significant, however, are the rules of the AAA, which specifically provide that arbitrators may award "*any remedy or relief* which the arbitrators deem just and equitable and within the scope of the agreement of the parties. . . ."⁷⁹

C. Judicial Interpretation

Since *McMahon*, the larger and more complicated cases are now being litigated in arbitration instead of before judges and juries. Although the SROs did not start making their awards public until after *McMahon*, it has been reported that between 1987 and 1990 nearly \$10,000,000 in punitive damages have been awarded in SRO and AAA securities arbitrations; and, several of these awards have been in amounts of one million dollars or more.⁸⁰ Such awards have served to escalate the simmering debate surrounding the authority to award punitive damages through arbitration.

At the state level, courts have been unable to unanimously agree upon the availability of punitive damages in arbitration.⁸¹ Most notable in opposing such arbitrable relief is the decision by the New York Court of Appeals in *Garrity v. Lyle Stuart, Inc.*,⁸² which involved a

77. See Katsoris I, *supra* note 25, at 452.

78. See P. HOBLIN, *supra* note 20, at supp. S5-43-49; S. GOLDBERG, *supra* note 17, at 2. No such designated space is provided on the NASD form of award. See Morris and Masucci, *supra* note 57, at 318-20.

79. AMERICAN ARBITRATION ASSOCIATION, SECURITIES ARBITRATION RULES § 43 (emphasis added). See also Friedman, *AAA Securities Arbitration: What You Need To Know*, in SECURITIES ARBITRATION 1991, at 405, 419 (PLI Seminar). As to an arbitrator's power to award injunctive relief, see Kavalier, Campbell, Rubinson, and Siskind, *An Overview of Industry Arbitration*, in SECURITIES ARBITRATION 1991, at 669, 686 (PLI Seminar). "Arbitration panels routinely award injunctive relief and may (and often do) vacate judicial injunctions. Affidavits of Edward W. Morris Jr., formerly NYSE Director of Arbitration and Robert Clemente, current NYSE Director of Arbitration. . . state that arbitration panels have the power to grant injunctive relief and have done so in the past." *Id.* See also THE ARBITRATOR'S MANUAL, *supra* note 19, at 19-22.

80. See S. GOLDBERG, *supra* note 17, at 119-35. The Goldberg Survey reports 44 punitive awards, 13 at the AAA and 31 at SROs. *Id.* at 132-33. Moreover, the geographical breakdown includes twelve states, namely: Florida (17); New York (7); California (5); Georgia (5); Texas (2); Wisconsin (2); and one each for Arizona, Missouri, North Carolina, Ohio, Oklahoma and Oregon. *Id.* See also *Woman Awarded \$419,000 Over Mishandled Brokerage Account* (Reuter Business Report), Sept. 4, 1991.

81. See *State Law on Punitive Damages*, 4 SEC. ARB. COMMENTATOR 1, at 10-11 (Jan. 1991).

82. 40 N.Y.2d 354, 353 N.E.2d 793 (1976).

dispute over payment of royalties. That court, some 15 years ago, ruled in a 4-3 decision that an arbitrator lacked authority "to award punitive damages, *even if agreed upon by the parties*."⁸³ The majority reasoned:

If arbitrators were allowed to impose punitive damages, the usefulness of arbitration would be destroyed. It would become a trap for the unwary given the eminently desirable freedom from judicial overview of law and facts. It would mean that the scope of determination by arbitrators, by the license to award punitive damages, would be both unpredictable and uncontrollable.⁸⁴

The *Garrity* holding takes on added significance because of the preeminence of New York as a situs for arbitration.⁸⁵

In disagreeing with the majority,⁸⁶ however, the three dissenting judges in *Garrity* reasoned: "[T]he public policy which 'favors the peaceful resolution of disputes through arbitration' outweighs the public policy disfavoring the assessment of punitive damages in this instance, where the unjustifiable conduct complained of is found to be with malice."⁸⁷ Interestingly, the only justice who partook in the *Garrity* case and still sits on the New York Court of Appeals is Judge Wachtler, currently that court's Chief Judge and one of the dissenters in *Garrity*.⁸⁸

Although some state courts disagree with the *Garrity* rationale,⁸⁹ it is the applicability of the FAA, with its strong policy in favor of arbitration and a full spectrum of available remedies,⁹⁰ that has led the assault against *Garrity*.⁹¹ Indeed, although most of the attack has occurred in the federal courts,⁹² it is interesting to note the language of Chief Judge Wachtler in a recent New York Court of Appeals decision, in which the entire court concurred:⁹³

Congress adopted the [Arbitration] Act to insure that the courts would rigorously enforce private agreements to arbitrate, and it es-

83. *Id.* at 356, 353 N.E.2d at 794.

84. *Id.* at 359, 353 N.E.2d at 796.

85. Approximately 30% of all SRO arbitrations are held in New York City. See Morris and Masucci, *infra* note 151 and accompanying text.

86. See *Garrity*, 40 N.Y.2d at 360-65, 353 N.E.2d at 797-801.

87. *Id.* at 363, 353 N.E.2d at 799.

88. See *id.* at 365, 353 N.E.2d at 801.

89. See *State Law on Punitive Damages*, *supra* note 81.

90. See *supra* notes 26-27 & 58-60 and accompanying text. See also Shell, *ERISA and Other Federal Employment Statutes: When is Commercial Arbitration an "Adequate Substitute" for the Courts?*, 68 TEXAS L. REV. 509 (1990).

91. See *infra* notes 98-133 and accompanying text.

92. See *infra* notes 93-134 and accompanying text.

93. *Singer v. Jeffries & Co.*, 78 N.Y.2d 76, 571 N.Y.S.2d 680 (1991).

tablishes an 'emphatic' national policy favoring arbitration which is binding on all courts, state and federal. Pursuant to the Arbitration Act, questions of arbitrability must be addressed with a healthy regard for the federal policy . . . and any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. As is the case with any contract, the intention of the parties is controlling, but [under the Arbitration Act] those intentions are generously construed as to issues of arbitrability.⁹⁴

Thus, if no interstate commerce is present,⁹⁵ an arbitrator sitting in New York who awards punitive damages clearly risks vacation of the award under *Garrity*;⁹⁶ however, since most securities cases do in fact involve an element of interstate commerce,⁹⁷ the FAA should generally apply. In such cases, the question then becomes whether the federal law pre-empts state law on the issue of arbitrability.⁹⁸

In fact, the issue of pre-emption has been debated frequently in the federal courts. In *Duggal International, Inc. v. Sallmetall*,⁹⁹ for example, a New York federal court refused to apply *Garrity* because it placed "substantive limits on arbitrability."¹⁰⁰ The *Duggal* court relied on the supremacy of federal law in reasoning that the FAA pre-empted New York state law.¹⁰¹ Furthermore, the court stated that given the broad mandate of the Arbitration Act, public policy exceptions to arbitrability should be sparingly created.¹⁰² The *Duggal* court then adopted language similar to that used by Judge Wachtler in *Singer v. Jeffries*,¹⁰³ and concluded that "courts must broadly construe the [arbitration] agreement and resolve all doubts in favor of the arbitrator's authority."¹⁰⁴ In addition, even though the intention of the parties is generally controlling, under the FAA "those intentions are generously construed as to issues of arbitrability."¹⁰⁵ This expan-

94. *Id.* at 81, 571 N.Y.S.2d at 682 (citations omitted).

95. *See supra* notes 27 & 59 and accompanying text.

96. *See supra* notes 82-84 and accompanying text.

97. *See supra* notes 58-60 and accompanying text. Indeed, the securities market can properly be described as *global* in nature. *See* Henriques, *Seeking Global Rules for Brokers*, N.Y. Times, July 14, 1991 § F (Money), at 15, col. 3; *Exchange Chief Predicts Global Stock Market Soon*, Wall St. J., April 10, 1991, at 8, col. 6.

98. *See infra* notes 99-134 and accompanying text.

99. No. 84 Civ. 7170, slip. op. (S.D.N.Y. 1986).

100. *Id.* at 3.

101. Specifically, *Duggal* looked to the Supreme Court's decision in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), which held that any state law in direct conflict with the Federal Arbitration Act violates the supremacy clause of the United States Constitution. *See also* *Moses H. Cone Memorial Hospital v. Mercury Const. Corp.*, 460 U.S. 1 (1983).

102. *Duggal*, No. 84 Civ. 7170, slip. op. at 4.

103. *See supra* notes 93-94 and accompanying text.

104. *Duggal*, No. 84 Civ. 7170, slip. op. at 4.

105. *Mitsubishi Motors v. Solar Chrysler*, 473 U.S. 614, 626 (1985).

sive role for arbitration was reinforced by the Supreme Court's decision in *McMahon*¹⁰⁶ which unanimously held that RICO claims — with their treble damage feature¹⁰⁷ — were specifically arbitrable.¹⁰⁸

In *Bonar v. Dean Witter Reynolds, Inc.*,¹⁰⁹ the United States Court of Appeals for the Eleventh Circuit reversed a punitive damage award issued in an AAA arbitration and remanded the case for a new hearing before a different panel of arbitrators because of a witness' perjury. In approving the arbitrator's authority to issue a punitive damage award under the broad AAA rules,¹¹⁰ the court — despite a New York choice-of-law provision invoking *Garrity's* prohibition on punitive damages — reasoned that "a choice of law provision in a contract governed by the Arbitration Act merely designates the substantive law that the arbitrators must apply in determining whether the conduct of the parties warrants an award of punitive damages; it does not deprive the arbitrators of their authority to award punitive damages."¹¹¹

The pre-emption and choice-of-law rationale invoked by the lower federal courts¹¹² came under attack in *Volt Information Sciences, Inc. v. Board of Trustees of the Leland Stanford Junior University*.¹¹³ The United States Supreme Court in *Volt* recognized a California choice-of-law clause which provided that the construction contract at issue would be governed by the law of "the place where the [p]roject is located."¹¹⁴ The *Volt* court reasoned:

We do not think the Court of Appeals offended the *Moses H. Cone* principle by interpreting the choice-of-law provision to mean that the parties intended the California rules of arbitration . . . to apply to their arbitration agreement. There is no federal policy favoring arbitration under a certain set of *procedural rules*; the federal policy is simply to ensure the enforceability, according to their terms, of private agreements to arbitrate. Interpreting a choice-of-law clause to make applicable state rules governing the conduct of arbitration — rules which are manifestly designed to encourage resort to the arbitral process — simply does not offend the rule of liberal construction set forth in *Moses H. Cone*, nor does it offend any

106. 482 U.S. 220 (1987).

107. See *supra* notes 62-64 and accompanying text. See also, SCHLUETER & REDDEN, *supra* note 1, § 19.1(L) at 313.

108. See *supra* notes 68-71 and accompanying text.

109. 835 F.2d 1378 (11th Cir. 1988).

110. See SECURITIES ARBITRATION RULES, *supra* note 79 and accompanying text.

111. 835 F.2d at 1387.

112. See *supra* notes 99-111.

113. 489 U.S. 468 (1989).

114. *Id.* at 470. See also Katsoris I, *supra* note 25, at 450 n.247.

other policy embodied in the FAA.¹¹⁵

Since many arbitration agreements contain a New York choice-of-law clause,¹¹⁶ the effect of *Volt* on the applicability of *Garrity* is unclear and unsettling. An *expansive* view of *Volt* takes the position that the opinion "endorsed the right of the parties to contract to agree on its terms and be bound thereby;"¹¹⁷ and, that "such contracts could be enforced so long as there is not pre-emption."¹¹⁸ Yet, a more *restrictive* interpretation reasons that *Volt* merely established:

... a *substance and procedure distinction*, with parties agreeing only to the application of the state's substantive law - *unless it is stated to the contrary*. Thus, with respect to punitive damages, a standard choice-of-law clause governed by the Federal Arbitration Act would be designating *only* that part of the state's law necessary to determine whether the conduct merits the awarding of such damages, not whether the arbitrators have the power to award them; the more important determination (i.e., the power to award) would be governed by federal law.¹¹⁹

The First Circuit adopted this restrictive interpretation in *Raytheon Co. v. Automated Business Systems, Inc.*,¹²⁰ which dealt with an AAA punitive award and a California choice-of-law provision. In upholding the punitive award on grounds that AAA rules give arbitrators broad authority to award any remedy or relief,¹²¹ the court refused to apply *Volt* in interpreting the choice-of-law clause.¹²² Instead, it distinguished *Volt* by reasoning that the instant case involved the very *scope* of the arbitration, thus requiring the application of the "'settled federal rule' that 'due regard must be given to the federal policy favoring arbitration, and ambiguities as in favor of arbitration.'"¹²³

The *Raytheon* decision, however, did not definitively dispense with the problems posed by reading *Volt* in conjunction with *Garrity*. In fact, the United States District Court for the Southern District of New York recently handed down two decisions involving *Garrity* —

115. 489 U.S. at 476 (emphasis added).

116. See S. GOLDBERG, *supra* note 17, at 80; Kupperman and Freeman III, *Selected Topics in Securities Arbitration: Rule 15c2-2, Fraud, Duress, Unconscionability, Waiver, Class Arbitration, Punitive Damages, Rights of Review, and Attorneys' Fees and Costs*, 65 TULANE L. REV. 1547, 1599 (1991).

117. Stewart, *Punitive Damages In Arbitration: Fish or Cut Bait*, N.Y.L.J., Feb. 21, 1991, at 5, col. 1.

118. *Id.* at 6.

119. *Id.* (emphasis added).

120. 882 F.2d 6 (1st Cir. 1989).

121. See *supra* notes 79 & 110 and accompanying text.

122. *Raytheon*, 882 F.2d at 11 n.5.

123. *Id.* at 11-12 n.5.

*Fahnestock v. Waltman*¹²⁴ and *Barbier v. Shearson Lehman Hutton, Inc.*¹²⁵ — which further muddled the waters. *Fahnestock* involved diversity jurisdiction¹²⁶ — but no choice-of-law clause — and a punitive damage award issued by a NYSE panel. In vacating the NYSE punitive award on the basis of *Garrity*, the court noted that although the NYSE rules contained no restriction on the awardability of punitive damages, its rules on arbitrators' powers were not as broad as the AAA's.¹²⁷ On appeal, the Second Circuit affirmed *Fahnestock* by a 2-1 decision, emphasizing the diversity aspect of the case.¹²⁸ In affirming the lower court, the Second Circuit noted, however, that the result might have been different if the NYSE's rules on arbitral authority were as broad as the AAA's.¹²⁹ Yet, a strict reading of *Garrity* would not permit such a holding since that court stated that "[a]n arbitrator has no power to award punitive damages, even if agreed upon by the parties."¹³⁰

Shortly after the Southern District decided *Fahnestock*, that same

124. No. 90 CIV 1792 (S.D.N.Y. Aug. 23, 1990).

125. 752 F. Supp. 151 (S.D.N.Y. 1990).

126. See 28 U.S.C. § 1332 (1991). But see Feinberg, *Is Diversity Jurisdiction An Idea Whose Time Has Passed?*, N.Y. STATE BAR J. 14 (July 1989). See also *infra* note 128.

127. See *supra* notes 78-79 and accompanying text.

128. *Fahnestock & Co. v. Waltman*, 935 F.2d 512 (2nd Cir. 1991). In discussing the diversity jurisdiction of the District Court, the Court of Appeals noted:

The award of the arbitrators was before the district court in this diversity case for review under state law. As previously noted, state law relating to the propriety of a punitive damage award by arbitrators in the absence of an agreement on the subject is not preempted by any federal substantive law bearing on the subject.

Ordinarily, '[i]n a diversity action, or in any other lawsuit where state law provides the basis of decision, the propriety of an award of punitive damages for the conduct in question . . . [is a] question[] of state law.' The measure of damages in general is a matter controlled by New York substantive law where federal jurisdiction in New York is predicated on the diversity of the parties. It follows that in this action the *Garrity* rule prohibiting the award of punitive damages by arbitrators must be applied. That the rule is grounded in state policy concerns renders it no less a rule of substantive law.

Id. at 518. (citations omitted). But see Beckley, *Go Down Moses: Fahnestock & Co., Inc. v. Waltman*, 4 SEC ARB. COMMENTATOR 1, 3 (1991):

The Second Circuit majority dodges the question by casually announcing that *Fahnestock* is based on diversity jurisdiction. *Moses Cone* was based on diversity; and it was *Moses Cone* which stated, "Although in some rare circumstances the presence of state-law issues may weigh in favor of . . . surrender [of federal jurisdiction] . . . the presence of federal issues must always be a major consideration weighing against surrender."

129. *Id.* at 519. See also *supra* notes 78-79 and accompanying text. The expansion of § 28 of the SICA Code to include broad arbitral authority similar to the AAA's is the subject of current debate.

130. 40 N.Y.2d at 356.

court, but a different judge, rendered its decision in *Barbier*, a case involving a New York choice-of-law provision and a NYSE punitive award.¹³¹ In upholding the punitive award, the court determined that the choice-of-law provision — which stated that “[t]his agreement shall . . . be governed by the laws of the State of New York”¹³² — was ambiguous. Thus, in the absence of a clear indication of the parties’ intent, the *Barbier* court adopted the narrow view of *Volt*, holding that the issue was not whether an arbitrator had the authority to award punitive damages, but rather, *whether punitive damages were warranted*¹³³ under the substantive law of New York. An appeal from the *Barbier* decision is currently pending before the same Second Circuit that decided the *Fahnestock* appeal.¹³⁴ Interestingly, the judge who wrote the majority opinion in the *Fahnestock* appeal is also a member of the panel which heard the *Barbier* appeal.

The outcome of this appeal,¹³⁵ however, is not likely to alleviate completely the concerns of arbitrators sitting in New York. To be sure, several important questions still remain unanswered. For example, should arbitrators consider: (i) whether or not the arbitration agreement has a choice-of-law provision;¹³⁶ (ii) whether or not that choice-of-law provision is ambiguous or specifically prohibits punitive damages;¹³⁷ (iii) whether the arbitration agreement constitutes a contract of adhesion;¹³⁸ (iv) whether there is diversity of citizenship among the parties;¹³⁹ (v) whether the damages fall below the federal diversity jurisdictional amounts;¹⁴⁰ (vi) whether the dispute is resolved by a NASD, NYSE or AAA arbitration panel;¹⁴¹ (vii) whether to *manifestly disregard*¹⁴² earlier relevant decisions and decide according to equitable assessments while awaiting guidance by the

131. 752 F. Supp. 151, 154.

132. *Id.* at 153.

133. *Id.* at 157. See also *supra* notes 117-19 and accompanying text.

134. *Barbier v. Shearson Lehman Hutton, Inc.*, No. 91-7070 (2d Cir. Sept. 3, 1991).

135. The appeal has been stayed pending the resolution of bankruptcy proceedings initiated by the appellant following oral argument in the case. See *Punitive Damages — In Brief*, 4 SEC. ARB. COMMENTATOR 4, at 4 (1991); *Securities Regulation Briefs*, 23 SEC. REG. & LAW REP. 1416, 1416-17 (1991).

136. See *supra* notes 109-33 and accompanying text.

137. See *Barbier*, 752 F. Supp. at 157.

138. See *infra* notes 158-77 and accompanying text.

139. See *supra* notes 126-28 and accompanying text.

140. Federal law requires a minimum damage claim of \$50,000. See 28 U.S.C. § 1332 (1991).

141. See *supra* notes 78-79 and accompanying text. See also Noah & Stroughter, *Arbitration At the American Stock Exchange*, in SECURITIES ARBITRATION 1989, at 567 (PLI Seminar).

142. See *infra* notes 200-04 and accompanying text.

United States Supreme Court,¹⁴³ (viii) whether, if two or more similar claims are joined, and only one of the claimants has an agreement containing a choice-of-law clause, punitive damages may be awarded to the latter but not the former;¹⁴⁴ (ix) whether, if just before or during the course of the arbitration — but before the award — a change in the claimant's "citizenship" from one which is different from the respondent to one which is the same as the respondent, removes the possible diversity jurisdiction rationale espoused in the *Fahnestock* case?¹⁴⁵ Little wonder such arbitrators would feel they were sitting in the *Tower of Babel*.¹⁴⁶

D. The Subtle Extension of the *Garrity* Influence

It must be emphasized that the purpose of arbitration is to provide a substitute for the expense and delay of court litigation, and that the prime goals of arbitration are speed and economy — without compromising fairness.¹⁴⁷ Accordingly, if arbitration is to remain a viable alternative to court litigation, it cannot be used as a vehicle to strip claimants of their remedies. Nor, on the other hand, can a national securities market be well served by fragmenting relief based upon geographical location or contractual wizardry. In other words, a New York customer defrauded by a broker should, for the most part, be entitled to the same relief as a customer in California who was similarly defrauded by the same broker — particularly if the trades were executed on the same exchange. To permit such unequal relief to arise from the inconsistent application of the *Garrity* prohibition ("the *Garrity* factor"), is unsettling in and of itself. Unfortunately, the uncertainty posed by *Garrity* would surely create a "spillover" effect by exerting a subtle influence over the resolution of other matters involving practice, procedure, and the administration of securities arbitrations. The problems posed by this potential spillover are discussed below.

1. *Effect on Joinder, Consolidation and Hearing Situs*

Section 13(d) of the Uniform Code specifically authorizes the joinder and consolidation of related claims, with the preliminary decision

143. See also *American Van Lines*, 204 N.Y.L.J. 43, Aug. 30, 1990, at 18, col. 1 (where the court stayed arbitration of a punitive damage claim).

144. See *supra* notes 109-34 and accompanying text.

145. See *supra* notes 126-28 and accompanying text.

146. See *supra* note 2 and accompanying text.

147. See *Katsoris I*, *supra* note 25, at 430-31. See also *Fletcher, Arbitrating Securities Disputes*, in *SECURITIES ARBITRATION 1990* (PLI Seminar).

resting with the SRO Director of Arbitration, and the final determination to be made by the arbitration panel.¹⁴⁸ Moreover, Section 14 of the Code provides that the situs of the initial hearing shall be determined by the Director of Arbitration.¹⁴⁹ In the case of a public customer, the arbitration is usually held "near where the customer resided when the dispute arose regardless of a predispute agreement to the contrary."¹⁵⁰ However, other factors such as the place where business was conducted, the location of witnesses, and jurisdiction over witnesses, for example, are also considered.¹⁵¹ Thus, a question arises regarding the extent to which the *Garrity* factor should be considered in making decisions pertaining to joinder, consolidation and hearing situs.

The issues posed by applying the *Garrity* factor in the above contexts are best examined through a series of hypotheticals. For example, suppose a claimant in the state of X purchases securities through the local offices of a New York-based brokerage firm, and in the course of the purchase, signs a pre-dispute arbitration agreement containing a New York choice-of-law provision. Suppose further that the claimant seeks punitive damages and wants the arbitration to be held in the state of X, his home state, whereas respondent broker prefers a New York situs because of the choice-of-law provision invoking *Garrity*. To what extent shall the Director of Arbitration of the SRO consider the *Garrity* factor in selecting the situs on the grounds that the state of X has adopted a more *restrictive* view of *Garrity* and *Volt* than the New York courts?¹⁵²

Analyzing the *Garrity* factor in light of circumstances similar to those present in the *Fahnestock*¹⁵³ case poses another procedural problem. In *Fahnestock*, the arbitration was held in New York, and the claimant filed a petition in the Eastern District of Pennsylvania to

148. See Katsoris I, *supra* note 25, at 438.

149. *Id.* at 439.

150. PROCEDURES BOOKLET, *supra* note 49, at 7.

151. See Masucci, *Maintaining The Fairness of Arbitration*, in SECURITIES ARBITRATION PRACTICE AND PROCEDURES 141, 150 (1989); L. LOWENFELS AND A. BROMBERG, SECURITIES INDUSTRY ARBITRATION: AN EXAMINATION AND ANALYSIS § 863, at 37. In 1990, the NYSE conducted hearings in 38 cities — 65% of which were held outside of New York City; similarly, NASD conducted hearings in 46 cities — over 70% of which were outside of New York City. See Morris and Masucci, *supra* note 57, at 235.

152. See *supra* notes 82-134 and accompanying text. See also Robbins, *Securities Arbitration from the Arbitrators' Perspective* in SECURITIES ARBITRATION 1991, at 71, 86 (PLI Seminar). "Because a New Yorker's threshold of outrage seems to be higher than that of individuals residing on the mainland, punitive damage awards are not as frequent in the Big Apple as they are throughout the rest of the country. But they are being awarded, with attorney's fees, even in New York." *Id.*

153. 882 F.2d 6. See *supra* notes 126-28 and accompanying text.

confirm the award pursuant to the NYSE Arbitration Rules.¹⁵⁴ Respondent subsequently filed a petition in the Southern District of New York to vacate the award under the FAA on the grounds that the arbitrators had exceeded their powers. The Pennsylvania federal court stayed the petition to confirm the arbitral award pending the outcome of the motion to vacate in the New York federal court. In deciding that New York was a more proper venue than Pennsylvania, the District Court in *Fahnestock*¹⁵⁵ reasoned that "since the award was made in this district, venue is proper here."¹⁵⁶ In our original hypothetical, however, suppose that: (a) the arbitration was held outside of New York in the state of X; (b) the claimant moves in the Federal District Court of X to confirm a punitive award rendered in an arbitration held in the state of X; (c) respondent, in a replay of *Fahnestock*, moves in New York to stay the confirmation action in the state of X; and (d) the Federal District Court in the state of X refuses to issue a stay based on the fact that the state of X is the more proper venue because the arbitration was held there.¹⁵⁷ Since that court's jurisdiction in the state of X does not necessarily depend upon diversity, would it therefore be less inclined to apply *Garritty*?

Similarly, suppose that two claimants — A (citizen of New York) and B (citizen of state Y) — have filed related claims in arbitration against the same respondent (citizen of New York); A has a New York choice-of-law provision in his arbitration agreement, whereas B has none; and, respondent moves to consolidate the two claims. Should such consolidation be denied because of possible prejudice to the punitive damage claims of either A or B? Indeed, these scenarios pose significant challenges for lawmakers.

2. *Contracts of Adhesion*

The suggestion that punitive damages can be eliminated in securities arbitration—either through the insertion of restrictive choice-of-law provisions (i.e., provisions applying New York law),¹⁵⁸ or clauses

154. Rule 627(a) provides that awards rendered by an arbitration panel "may be entered as a judgment in any court of competent jurisdiction."

155. No. 90 CIV 1792, 1990 U.S. Dist. LEXIS 11024 (S.D.N.Y. 1990).

156. *Id.*, slip. op. at 15. Although the court found venue proper in both New York and Pennsylvania, it chose on the basis of 28 U.S.C. § 1404(a) (1991). *Id.* "For the convenience of the parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought." *Id.*

157. In *Fahnestock*, No. 90 CIV 1792, the arbitration was held in New York, a fact which was accorded significant weight by the court in deciding whether to transfer the case to Pennsylvania. *See supra* notes 154-56.

158. *See Barbier*, 752 F. Supp. at 157.

specifically prohibiting such awards¹⁵⁹—raises interesting possibilities. For example, assume that through *coincidence, design, osmosis, capillary action, gravity, or the law of the jungle*, such clauses find their way into most pre-dispute securities arbitration agreements.¹⁶⁰ At that point the issue of adhesion should be closely examined.¹⁶¹

The doctrine of adhesion provides a basis for refusing to enforce a contractual agreement.¹⁶² Adhesion arises when a standardized contract, usually drafted by a party of superior bargaining power, is presented to a party whose choice is limited to accepting or rejecting the contract without having the opportunity to negotiate its terms.¹⁶³ Such agreements usually exist when a party enters into similar transactions with many individuals,¹⁶⁴ and the agreements resemble ultimatums or laws rather than mutually negotiated contracts.¹⁶⁵

Generally, there are two judicially imposed limitations on the enforcement of adhesion contracts or their provisions: first, regardless of any general "duty to read," such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him;¹⁶⁶ second, a contract or a provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive, unconscionable or against public policy.¹⁶⁷ A

159. *Id.*

160. See Stewart, *supra* note 117.

[I]n the interim, attorneys who are drafting arbitration agreements, and who wish to bar the arbitrators' ability to award punitive damages, should consider doing at least the following two things: first, state specifically that New York substantive and procedural law is to govern the proceedings; and second, state that the application of New York law is to the exclusion of any other state's law and federal law, except where federal law is in direct conflict.

Id. at 6 (emphasis added).

161. See *infra* notes 162-77 and accompanying text.

162. See J. CALAMARI & J. PERILLO, CONTRACTS § 9-41 to 9-46 (3d ed. 1987) [hereinafter CALAMARI & PERILLO].

163. *Id.*; see also QUINN, UNIFORM COMMERCIAL CODE COMMENTARY AND LAW DIGEST -302[A] at -95-96 (1978).

164. Kessler, *Contracts of Adhesion — Some Thoughts About Freedom of Contract*, 43 COLUMB. L. REV. 629, 631 (1943); Lenhoff, *Contracts of Adhesion and the Freedom of Contract: A Comparative Study in the Light of American and Foreign Law*, 36 TUL. L. REV. 481, 481-82 (1962).

165. See Siegelman v. Cunard White Star Ltd., 221 F.2d 189, 206 (2d Cir. 1955); Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 553 (1971).

166. See *Graham v. Scissor-Tail, Inc.*, 28 Cal.3d 807, 818, 623 P.2d 165, 172-73, 171 Cal.Rptr. 604, 612 (1981).

167. See *id.*; cf. *Chretien v. Donald L. Bren Co.*, 151 Cal. App. 3d 385, 388, 198 Cal. Rptr. 523, 525, (1984) (court may deny enforcement of a nonadhesive contract if terms are unconscionable, or may limit application of any unconscionable clause). It would

great deal has been written about the interrelationship of the duty to read, reasonable expectations, unconscionability and public policy,¹⁶⁸ but it is unnecessary to broadly review such material in this article. Instead, the inquiry must be narrowed to the subject at hand by making certain assumptions.

First, assume that a customer is required to sign an arbitration clause typical of the clauses found in standard broker-customer securities agreements before he can open an account.¹⁶⁹ Would a customer be relieved of his arbitration obligation because there was no duty to read, and consequently no true assent? This is apparently not the case, given that the investor could reasonably have expected to find a pre-dispute arbitration clause in the agreement.¹⁷⁰ Would such a clause be contrary to public policy? Again, probably not, because of the policies underlying the Arbitration Act.¹⁷¹

A more interesting question, however, focuses on whether a typical industry-wide arbitration agreement, regularly imposed by the securities industry upon its customers,¹⁷² may be considered unenforceable on grounds that it is unduly oppressive or unconscionable. Although this type of transaction constitutes "commerce" and is therefore covered by the Arbitration Act,¹⁷³ the point is not a moot one since there is an exception when grounds exist, at law or in equity, for the revocation of any contract.¹⁷⁴

While some courts have recognized the issue of adhesion, it appears that most courts have not considered adhesion to be a problem in the case of customer agreements containing securities arbitration clauses.¹⁷⁵ In those cases, however, the clause at issue usually involved the arbitration of securities disputes before one or more of the SROs. If these arbitration clauses are now expanded to also deny pu-

appear, however, that the burden of establishing unconscionability is greater in the case of a freely negotiated contract than it is when a party of superior bargaining power imposes an industry-wide form upon the weaker party. See *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 386, 161 A.2d 69, 84 (1960). One commentator has noted that "[a]n arbitration clause is especially vulnerable to attack if one party has not voluntarily agreed to it, because a fundamental factor in the courts' willingness to enforce arbitration clauses is their voluntary nature." Wright, *Arbitration Clauses in Adhesion Contracts*, 33 ARB. J. at 43 (1978) (footnote omitted); Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529, 549-61 (1983).

168. See CALAMARI & PERILLO, *supra* note 163, § 9-37-46 at 398-428.

169. See Katsoris I, *supra* note 25 and accompanying text.

170. *Id.*

171. See *supra* notes 90-98 and accompanying text.

172. See Katsoris I, *supra* note 25 and accompanying text.

173. 9 U.S.C. §§ 1-14 (1982).

174. *Id.* § 2.

175. See Katsoris II, *supra* note 32, at 373-74.

nitive damages, the courts should re-examine whether such clauses are oppressive or unconscionable;¹⁷⁶ and if the courts do not, then Congress should take up the issue.¹⁷⁷

V. The Garrity Tradeoff

One of the principle purposes of the SICA Code was to achieve uniformity in handling disputes between customers and their brokers.¹⁷⁸ Consequently, geographic "Balkanization"¹⁷⁹ of these dispute resolution procedures — and the resultant relief — is not desirable. Indeed, the court in *Securities Industry Association v. Connolly*,¹⁸⁰ which ruled that a state's restriction on the signing of a pre-dispute arbitration agreement was pre-empted by the FAA,¹⁸¹ discouraged fragmentation of regulation.¹⁸²

It follows that the basic treatment of punitive damages in securities arbitration disputes should also be uniform, particularly since arbitrators are dealing with markets that are national in scope and interstate by nature. For example, punitive damages are uniformly denied in the case of federal securities law violations;¹⁸³ yet treble damages *must* be awarded for RICO violations.¹⁸⁴ Accordingly, why can't there be a uniform rule to govern punitive damages for non-federal securities law violations?

To be sure, punitive damages are not routinely awarded.¹⁸⁵ This is so because of the higher burden of proof which generally requires a showing of gross, wanton or willful fraud or other morally culpable conduct.¹⁸⁶ To eliminate punitive damages in securities cases, however — through restrictive choice-of-law clauses or otherwise — would encourage and condone unscrupulous conduct by brokers if they were assured that their liability would be limited solely to compensatory damages.¹⁸⁷ Indeed, assurance that respondents in securi-

176. See *supra* note 167 and accompanying text.

177. See *infra* note 230.

178. See *supra* notes 39-57 and accompanying text.

179. "To cause (as a region) to separate into hostile units; referring to the inharmonious conditions prevailing in the Balkan states (Bulgaria, Romania, Serbia, etc.), especially at the time of the Balkan Wars (1912-13)." See WEBSTER'S NEW INTERNATIONAL DICTIONARY 208 (2d ed. 1943).

180. 703 F. Supp. 146 (D. Mass. 1988), *aff'd*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied*, 1105 S. Ct. 2559 (1990).

181. *Id.* at 153. See also *supra* notes 90-98 and accompanying text.

182. *Id.* at 155.

183. See *supra* note 61.

184. See *supra* notes 62-71 and accompanying text.

185. See SCHLUETER & REDDEN, *supra* note 1, § 2.1(c) at 23.

186. *Id.*

187. See S. GOLDBERG, *supra* note 17, at 2.

ties disputes would be free from punitive damage sanctions would also discourage equally culpable brokerage firms from entering into meaningful settlement negotiations — no matter how outrageous their conduct. In other words, why should a respondent make a realistic settlement offer at the outset if the customer is prohibited from receiving greater relief after a lengthy and costly proceeding?¹⁸⁸ The solution to this dilemma lies in allowing punitive damages to be awarded in arbitration to the same extent permitted in courtroom litigation; however, a compromise should be reached in order to allay the *Garity* court's fears of non-reviewable, runaway awards.¹⁸⁹

The first element of the compromise — or “tradeoff” — proposes that punitive awards rendered through arbitration should be readily reviewable.¹⁹⁰ Second, it is somewhat illogical that arbitrators are perfectly capable of meting out treble RICO awards, which are punitive in nature,¹⁹¹ but incapable of issuing punitive damage awards. Accordingly, to eliminate this inconsistency of treatment and insure that no exemplary overlap occurs between treble damages under RICO and punitive damages,¹⁹² it is further suggested that this tradeoff include the elimination or restriction of RICO claims. Thus, in exchange for a uniform nationwide rule permitting arbitrators to impose punitive damages in securities disputes, (a) such awards should be generally reviewable, and (b) RICO claims should be severely restricted or eliminated.¹⁹³ The balance of this section will examine the elements of this tradeoff.

A. Judicial Review

The scope of judicial review of an arbitration award is very lim-

188. *Id.*

189. *See supra* notes 82-84 and accompanying text.

190. *See infra* notes 194-200 and accompanying text.

191. *See supra* notes 62-67 and accompanying text. *See also infra* notes 212-20 and accompanying text.

192. To the extent such overlap may exist, either *de facto* or *de jure*, see D. ABRAMS, *supra* note 64, § 3.4.2, at 157-58: “Where a civil RICO claim is joined with state or other federal claims, however, most decisions conclude that an otherwise permissible punitive damage award remains available on a non-RICO claim. A Ninth Circuit panel, however, suggested (without deciding) that RICO might preempt punitive damage awards on state claims that are based on the same underlying activity that gives rise to the civil RICO claim. In any event, at least one decision declined to impose punitive damages on a non-RICO claim on the grounds that civil RICO trebling itself imposed sufficient punishment on the defendant.”

193. The proposed tradeoff clearly suggests Congressional action at some level, most probably by amending the FAA and revising the RICO statute.

ited.¹⁹⁴ "If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, either in law or fact."¹⁹⁵ In fact, the typical grounds for vacating an arbitration award¹⁹⁶ are surprisingly uniform throughout the United States.¹⁹⁷ Furthermore, finality of the award is one of the principal advantages of arbitration, in that it avoids the costs and delays of endless appeals.¹⁹⁸ Thus, an award which has a legal or factual basis which may be rationally inferred from the evidence will be upheld.¹⁹⁹ Nonetheless, although courts generally will not set aside an award for a mistake of law, they will so vacate where the arbitrators have acted in "manifest disregard" of the law.²⁰⁰

194. See Goldberg, *A Supreme Court Justice Looks at Arbitration*, 20 ARB. J. 13, 14-15 (1965).

195. Burchell v. Marsh, 58 U.S. 344, 349 (1854).

196. On this point, the FAA provides:

In either of the following cases the United States court in and for the district wherein the award was made may make an order vacating the award upon the application of any party to the arbitration—

- (a) Where the award was procured by corruption, fraud, or undue means.
- (b) Where there was evident partiality or corruption in the arbitrators, or either of them.
- (c) Where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced.
- (d) Where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.
- (e) Where an award is vacated and the time within which the agreement required the award to be made has not expired the court may, in its discretion, direct a rehearing by the arbitrators.

9 U.S.C. § 10 (1991). See also Krebsbach & Friedman, *Defending Brokerage Firms Against Customer Complaints* in SECURITIES ARBITRATION 1991, at 589, 614-15 (PLI Seminar); Kavalier, Campbell, Rubinson & Siskind, *supra* note 79, at 708-09.

197. See Goldberg, *supra* note 182, § 6.03 at 63; see also Smiley, *Stockbroker-Customer Disputes; Making A Case for Arbitration*, 23 GA. ST. B.J. 195 (1987).

198. See Smiley, *supra* note 197, at 200.

199. *Id.* As to the possibility of sanctions for frivolous challenges, see Brunelle, *Judicial Proceedings in Aid of Arbitration*, in SECURITIES ARBITRATION 1991, at 733, 741 (PLI Seminar): "Challenging an arbitral award in a U.S. District Court carries with it a serious risk that if the petition is unsuccessful, and the Court finds it to have been frivolous, the petitioner and its counsel may be sanctioned under Fed. R. Civ. P., Rule 11. Quick & Reilly, Inc. v. Jacobson, 126 F.R.D. 24 (1989). Although sanctions may also be imposed by the New York State Courts, 22 NYCRR § 130.1-1(a), the risk in that forum, as a practical matter, is much lower. Ministers, Elders & Deacons, etc. v. 198 Broadway, Inc., 76 N.Y.2d 411 (1990)." See also Vairo, *Rule 11 Sanctions: Case Law Perspectives and Preventive Measures*, in PRENTICE HALL LAW AND BUSINESS 107-09 (1990); *Uneven Use Mars Rule 11*, Nat. L.J., Aug. 5, 1991, at 13, col. 1.

200. See Smiley, *supra* note 197, at 200.

"Manifest disregard" of the law is a judicially created ground for vacating an arbitration award "even though not specifically listed under 9 U.S.C. § 10 of the Federal Arbitration Act."²⁰¹ Although the limits on the use of this rationale have never been definitively outlined, "manifest disregard" clearly means more than mere error or misunderstanding with respect to the law.²⁰² For an award to be vacated under this theory, "the error must have been. . . readily and instantly perceived by the average person qualified to serve as an arbitrator."²⁰³ "Moreover, the term 'disregard' implies that the arbitrator appreciated the existence of a clearly governing legal principle but decides to ignore or pay no attention to it."²⁰⁴

Given the limited grounds for vacating an award, how can the *Garity* fear of non-reviewability be alleviated? Some have suggested bifurcated proceedings²⁰⁵ — that is, to try the punitive claim separately before a judge or jury. The delay, extra cost and possibility for inconsistent or incompatible outcomes that could result from such a procedure is hardly the panacea for a court system clogged with other cases.²⁰⁶ On the other hand, letting the arbitrators decide the entire case, and requiring that only the punitive damage portion of the

201. *Fahnestock*, 1190 U.S. Dist. Lexis 11024, slip. op. at 6 (1990).

202. See *Merrill Lynch, Pierce Fenner & Smith v. Bobken*, 808 F.2d 930 (2d Cir. 1986).

203. *Id.* at 933.

204. *Id.*

205. See 4 SEC. ARB. COMMENTATOR 1, at 4 (Jan. 1991); see also COMMERCIAL AND FEDERAL LITIGATION SECTION OF THE NEW YORK STATE BAR ASSOCIATION, REPORT ON PUNITIVE DAMAGES IN COMMERCIAL ARBITRATION (1990). Some commentators have suggested "[p]rohibiting arbitrators from awarding punitive damages under any circumstances, but providing a procedure for a prevailing party in arbitration to seek punitive damages in a subsequent court proceeding (which procedure might be made available (a) generally, or (b) only if the parties expressly reference it in their agreement)." *Id.* at 24.

206. See *New Tactics in the War on Drugs Tilt Scales of Justice Off Balance*, N.Y. Times, Dec. 29, 1989, at A1, col. 1. "'We're becoming drug courts,' says Edward R. Becker, a Federal appeals judge in Philadelphia. . . . 'The short of it is that we're getting an enormous volume of drug cases and its making it very difficult in many jurisdictions to hear civil cases.'" See also Wise, *City's Federal Trial Courts Show Rise in Pending Cases*, N.Y.L.J. Sept. 11, 1991, at 1, col. 3; *The Federal Courts Have a Drug Problem*, Bus. Wk., Mar. 26, 1990 at 76; *Drastic Moves Urged to Ease U.S. Court's Load*, N.Y. Times, Mar. 23, 1990, at B5, col. 3. Indeed, in California, the Los Angeles County Bar Association filed suit in Federal court to appoint more state court judges because it takes about five years for a civil case to come to trial. See Marcotte, *L.A. County Bar Sues California*, 74 A.B.A. J. 28 (1988). See also *Lawsuits in Federal Courts*, N.Y. Times, July 16, 1987, at B6, col. 6; *Congress Now Considering Dispute Resolution Measures*, Nat. L.J., Feb. 5, 1990, at 1, col. 1; Randall Sanborn, *Courting Solutions*, Nat. L.J., July 1, 1991, at 1, col. 1; Verhovek, *Chief State Judge Is Suing Cuomo To Get More Money for the Courts*, N.Y. Times, Sept. 26, 1991, at A1, col. 5.

award be subject to general judicial review,²⁰⁷ would be more efficient and could serve to alleviate some of the apprehension expressed by the court in *Garrity*.²⁰⁸ To make such review meaningful, however, a record of the proceedings must be kept;²⁰⁹ otherwise, to attempt to reconstruct what occurred during the arbitration proceedings would invariably result in a battle of affidavits.²¹⁰ Similarly, awards should be in writing, and should clearly and separately identify the components of the award.²¹¹ Moreover, in the case of a punitive damage award, explaining the grounds for its rendition should be encouraged. Only with these safeguards can a reviewing body understand the rationale of a punitive award in order to meaningfully judge its adequacy.

B. Elimination of RICO

Allowing for reviewability of punitive damage awards rendered through arbitration calls to mind the present non-reviewable status of RICO treble damage awards in such proceedings.²¹² As is the case with punitive damages, the awarding of treble damages under RICO is currently the subject of much debate, and has become equally problematic in the context of arbitration.²¹³ This is particularly true since such damages are routinely pleaded as alternative relief in statements of claim.²¹⁴

The *McMahon* decision clearly recognized the arbitrability of RICO treble damage claims in securities disputes.²¹⁵ Much discus-

207. This could be accomplished by adding punitive damages as a grounds for vacating that portion of an award under the FAA. See *supra* notes 196-97 and accompanying text.

208. See *supra* notes 82-84 and accompanying text. Although such review might admittedly slow down the arbitration process, this effort would be limited to the relatively few instances where punitive damages were awarded, and would clearly be justified on the grounds of fairness. Moreover, a review procedure would be much more desirable than allowing punitive damage claims to be tried in bifurcated proceedings. See Friedman, *Punitive Damages in Securities Cases*, N.Y.L.J., May 2, 1991, at 3, 30. As to the undesirability of bifurcated proceedings generally, see Katsoris III, *supra* note 35.

209. Such a record is already required by the SICA code. See Katsoris I, *supra* note 25 at 446. See also Katsoris, *I Won't Sit Without a Record*, 3 SEC. ARB. COMMENTATOR 9, at 1, col. 2 (Sept. 1990).

210. *Id.* at 2.

211. See Morris, *Arbitration At The New York Stock Exchange*, in SECURITIES ARBITRATION PRACTICE AND PROCEDURE 95, 119 (Nov. 17, 1989) (on file at the office of the Fordham Urban Law Journal).

212. In fact, the FAA does not reference RICO in its discussion of grounds for vacating an arbitration award. See *supra* note 196 and accompanying text.

213. See *supra* notes 62-70 and accompanying text. However, this article need not examine all the elements of the RICO debate in detail.

214. See Katsoris I, *supra* note 25, at 449.

215. See *supra* notes 68-71 and accompanying text.

sion has been generated, however, over whether RICO should be restricted or abolished — not just in securities arbitration, but in civil litigation generally.²¹⁶ Indeed, the overall desirability of permitting RICO allegations in securities arbitration is questionable. In the first place, although such damage claims are routinely pleaded, they are seldom proven. By the same token, the mere allegation of a securities violation under RICO severely bogs down the arbitration proceeding.²¹⁷ Most importantly, perhaps, is the fact that arbitration awards under RICO are generally not reviewable.²¹⁸ Certainly, it is inconsistent to suggest that punitive damage awards in securities arbitrations should be reviewable while RICO treble damage awards are not. In addition, assuming that punitive damages become universally available in securities arbitrations, the potential for *de facto* overlap be-

216. See *RICO v. RICO*, Wall St. J., Dec. 14, 1989, at A22, col. 1; *RICO's Taxing Problem*, Wall St. J., Aug. 22, 1989, at A14, col. 3; *RICO: The Law as Thug*, Wall St. J., Nov. 13, 1989, at A11, col. 1; *Uncertain Future for RICO Cases, Business and the Law*, N.Y. Times, Nov. 13, 1989, at D2, col. 1; *High Powered Bid to Gut RICO Law is Derailed By Unrelated Scandals, Backers' Seeming Greed*, Wall St. J., Nov. 9, 1989, at A18, col. 1. It is interesting to note the following *pro* and *anti* RICO lobbies:

For Proposed RICO limits:

- * National Association of Manufacturers
- * AFL-CIO
- * American Civil Liberties Union
- * American Institute of Certified Public Accountants
- * American Bar Association
- * American Bankers Association
- * Securities Industry Association
- * American Life League (anti-abortion group)
- * Defendants in pending civil RICO cases

Against proposed RICO limits:

- * Public Citizen (Ralph Nader consumer group)
- * U.S. Public Interest Research Group (state consumer groups)
- * National Association of Insurance Commissioners
- * National Association of Attorneys General
- * National Association of Securities and Commercial Law Attorneys (plaintiffs' lawyers)
- * Plaintiffs in pending RICO cases.

Id. See also *RICO and The Securities Laws*, N.Y.L.J., June 12, 1981, at 3, col. 1; *Review and Outlook, RICO's Stinkin' Badges*, Wall St. J., July 5, 1991, at A6 col. 1; D. ROBBINS, *SECURITIES ARBITRATION PROCEDURE MANUAL* 28-31 (1990); *House Subcommittee Approves Bill to Limit Use of Civil Rico Lawsuits*, 23 SEC. REG. & LAW REPT. 711, 726 (1991); McMillion, *ABA Seeks End of Civil RICO Abuses*, A.B.A. J. (Oct. 1991).

217. As to the complexities of RICO, see generally Abrams, *Civil RICO's Cause of Action: The Landscape After Sedima*, 12 TULANE MAR. L.J. 19 (1988). See also Page, Smiley, & Goddard, *Representing Customers in Securities Arbitration*, in *SECURITIES ARBITRATION* 1991, 527, 549 (PLI Seminar): "Although treble damages are provided for under the federal RICO statutes and in some state RICO statutes, arbitrators are reluctant to award RICO damages." *Id.*

218. See *supra* notes 196 & 212 and accompanying text.

tween these damages and RICO treble damage awards militates in favor of restricting or abolishing altogether RICO claims in securities disputes.²¹⁹ For all of these reasons, the application of RICO in securities matters should be narrowed or eliminated, leaving punishment and deterrence to be doled out in the form of punitive damages and SRO discipline.²²⁰

VI. Conclusion

When a dispute persists between a customer and a broker, the path to relief is generally arbitration or court litigation. The choice, however, should only involve the differences in procedure, not the quantum of relief sought. The procedural differences, therefore, should not result in less relief because one forum is chosen over the other. To create such an imbalance is unconscionable, particularly if the forum of less relief is effectively *mandated* upon the public.²²¹

Whether punitive damages should be generally awarded is not the question. Rather the issue is whether a claimant should expect the same remedies in arbitration as in courtroom litigation. The answer is decidedly yes! Arbitration still has an image problem, despite great efforts to create a level playing field.²²² To saddle arbitration with the restriction that it provides for less relief than available in court would rekindle the suspicion that SRO arbitration creates an atmosphere of a stacked deck.²²³

219. Whether or not such overlap exists as a matter of law, however, is yet undecided. See Abrams, *supra* note 192. Nonetheless, the possibility of overlap could prove mischievous in the rendering of arbitration awards. For example, when faced with a punitive situation, will the arbitrator award general punitive damages, damages pursuant to RICO, or both? Moreover, would the fact that one was generally reviewable and the other not, influence arbitrators in making such a choice? This possibility poses a problem similar to that which the *Garrity* court feared. See *supra* notes 82-84 and accompanying text.

220. As discussed earlier, the securities industry seems willing to handle such a task. See, e.g., Katsoris I, *supra* note 25, at 450. See also *Brokers, Firms Are Disciplined for Violations*, Wall St. J., July 5, 1991, at B3A, col. 5; Pritchett, *Ex-Broker Gets \$2.25 Million Fine In Fraud Case*, Wall St. J., July 8, 1991, at C16, col. 4; *NASD Announces Disciplinary Actions Against Number of Firms and Persons*, Wall St. J., Aug. 16, 1991, at A3A, col. 1. For an example of such disciplinary authority, see NASD Code of Procedures, Art. IV, § 1 in NASD MANUAL (CCH) ¶ 3049, at 3151.

221. See Katsoris I, *supra* note 25 and accompanying text.

222. See Herriques, *When Naïveté Meets Wall Street*, N.Y. Times, Dec. 3, 1989, § 3 at 1, col. 2. See also *Is the Game Rigged?*, Newsweek, Sept. 30, 1991, at 49.

223. See *Shearson/American Express v. McMahon*, 482 U.S. 220, 260 (1987) (Blackmun, J. dissenting). In his dissenting opinion, Justice Blackmun was troubled by the nagging complaint that we may be "compelling an investor to arbitrate securities claims . . . in a forum controlled by the securities industry." *Id.* This stems from a belief by some that the uniform opposition of investors to compel arbitration and the overwhelm-

If punitive damages in arbitration are not generally reviewable, while those obtained in courtroom litigation are, then the arbitration playing field would tilt in favor of claimants. Accordingly, along with providing similar relief — in other words, treating punitive damages in arbitration just as they are treated in courtroom litigation — the law must also provide for the reviewability of such awards.²²⁴ Thus, insuring the awardability of punitive damages in arbitration requires simultaneous judicial reviewability of such awards.²²⁵ At the same time, and as part of the package, lawmakers should seize the opportunity to effectively yet fairly streamline the resolution of securities disputes — both in arbitration and courtroom litigation — by eliminating, or at least limiting, the often duplicitous and parallel RICO remedy in such disputes.²²⁶ In this manner, exemplary damages would be meted out through reviewable discretionary punitive damage awards, instead of non-reviewable RICO awards obtained in arbitration.²²⁷

Finally, if the securities industry wishes to reign-in punitive damage exposure, it should do so on a broad front and not just in arbitration through *Garrity*. Otherwise, arbitration will become the industry's *Trojan Horse*²²⁸ by attempting to achieve indirectly — through basically adhesive agreements²²⁹ — what it cannot get the courts or Congress to do directly.²³⁰ Such a tilting of the playing field would no

ing support of the securities industry for the process suggests that there must be some truth to the investors belief that the securities industry has an advantage in a forum under its own control. See Glaberson, *When The Investor Has A Gripe*, N.Y. Times, Mar. 29, 1987, § 3, at 8, col. 1 (“[t]he houses basically like the present system because they own the stacked deck”)

224. To permit punitive damage awards issued by courts and juries to be generally reviewable, while prohibiting review of such awards issued in arbitration, would tilt the arbitration playing field in favor of claimants.

225. See *supra* notes 190-93 and accompanying text.

226. *Id.*

227. *Id.*

228. See THE ODYSSEY OF HOMER 132-33 (trans. by E. V. Rieu 1932).

229. See *supra* notes 158-77 and accompanying text.

230. See Hinden, *GAO Asked To Investigate Securities Arbitration Issues*, Wash. Post, Feb. 7, 1990, at 2, col. 1. See also request by Congressmen Bowsher, Dingell and Markey to General Accounting Office (“GAO”) for a “Comprehensive Study of Securities industry practices with respect to pre-dispute arbitration clauses in customer agreements and of the arbitration process as sponsored by the securities industry self-regulating organizations (SROs).” 3 SAC 1&2(7); Ketchum letter from SEC to SROs dated May 10, 1990 concerning alternative forums; see MORRIS AND MASUCCI, *supra* note 57, at 260-63. See also Martin, *Court Rulings Could Spur Congress on Arbitration*, 23 Institutional Investor Inc., Wall Street Letter, No. 14 at 1 (April 8, 1991); Year in Review, 3 SAC 12, at 3, 4. “As 1991 proceeds, we expect to see renewed Congressional hearings on the SRO arbitration process. Where those hearings will lead could easily spell out arbitration’s future. In any case, the stage is being set for some kind of climactic action that will either challenge

doubt surprise both Hammurabi²³¹ and Aristotle,²³² but more importantly, would surely tarnish the image of arbitration as an effective alternative mechanism for settling securities disputes.

the use of mandatory. . . [mandatory pre-dispute arbitration] or result in a major change on the 'forum of choice' front." *Id.* See also *supra* notes 10-12, 99-134 and accompanying text.

231. See *supra* note 4 and accompanying text.

232. See *supra* note 19 and accompanying text.